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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	

REPLY COMMENTS OF THE NEW ENGLAND CABLE TELEVISION ASSOCIATION, INC. IN RESPONSE TO THE FEDERAL COMMUNICATIONS COMMISSION'S FURTHER NOTICE OF PROPOSED RULEMAKING ON VIDEO DIALTONE PRICE CAP TREATMENT

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May 17, 1995

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TABLE OF CONTENTS

Page

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The New England Cable Television Association, Inc. ("NECTA"), by its attorneys, hereby submits its reply comments in the above-captioned proceeding.[1/] NECTA is a six-state regional association representing cable television operators in Massachusetts, Rhode Island, Maine, Vermont and New Hampshire, as well as Connecticut. The majority of its members are cable operators in those states and include both small rural systems and national multiple system operators.

NECTA's reply comments respond primarily to the comments of The NYNEX Telephone Companies ("NYNEX"), the LEC that provides telephone service to, and is the announced video competition to NECTA's members in, the majority of the above states. NECTA notes that in light of the incentives of LECs such as NYNEX to misallocate costs of video dialtone to telephony services, the FCC should be wary of NYNEX's plea for less

[1/] In the Matter of Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation, Further Notice of Proposed Rulemaking, CC Docket No. 94-1, FCC 95-49 ("VDT Price Cap Notice") (released Feb. 15, 1995).

regulatory oversight of its video dialtone service offerings. Moreover, the Commission should note that since NYNEX has elected the low-end productivity offset of 4.0 percent, it has particular incentives to shift costs from competitive services, such as video dialtone, to monopoly telephone services.

I. A SEPARATE VIDEO DIALTONE BASKET IS A NECESSARY, BUT NOT SUFFICIENT, MECHANISM THAT THE FCC MUST ESTABLISH TO ADDRESS THE THREAT OF LEC CROSS-SUBSIDIZATION

NECTA strongly opposes NYNEX's arguments that the Commission should remove video dialtone ("VDT") from price-cap regulation and subject VDT to streamlined regulation on the grounds that VDT is a competitive new service.[2/] Video dialtone is a service where the incentives for improper cross-subsidization are especially strong. LECs such as NYNEX are new entrants in the video marketplace with powerful economic assets and with every incentive to gain a competitive edge in the marketplace.[3/]

[2/] NYNEX Comments at 1 (filed April 17, 1995).

[3/] NYNEX has demonstrated its propensity to misallocate video dialtone costs in the past. For example, NYNEX has acknowledged in the course of a Massachusetts Department of Public Utility proceeding that $513,000 in video dialtone costs relating to its New York video dialtone trial were incorrectly included in New England Telephone's 1993 Massachusetts intrastate operating results. See NECTA Petition to Deny NYNEX's Video Dialtone Applications for Massachusetts and Rhode Island, In the Matter of the Application of New England Telephone and Telegraph Company, File Nos. W-P-C 6982, 6983, at pp. 11-12 and Exhibits No. 1 and 2 (citing NYNEX's response to NECTA's Interrogatory Request No. 1-29 in the NYNEX Petition for Alternative Form of Regulation, DPU 94-50 before The Commonwealth of Massachusetts Department of Public Utilities).As the Attorney General for the Commonwealth of Massachusetts stated in comments filed in that same proceeding, "NYNEX wants to have a free ride, to keep all of the rewards of any of the upside of its investment in cable TV business, while burdening the telephone ratepayers with the risks and the costs of all of the downside of that business. NYNEX Petition for Alternative Form of Regulation, DPU 94-50, Reply Brief of the Attorney General, at 67 (filed January 11, 1995).

Given the strong governmental interest in protecting telephone ratepayers from subsidizing the costs of video dialtone, NECTA believes that a separate VDT price cap basket is a necessary, but not sufficient, mechanism that the Commission must establish to ensure that the overriding goal of preventing cross-subsidization and anticompetitive behavior in the video services marketplace is preserved.[4/] To do this, the FCC must not only implement a separate price cap basket for VDT services, it also must reaffirm its commitment to thorough and ongoing scrutiny of the cost studies of NYNEX and other LECs for both VDT and telecommunications services when such services are provided over a common network. In this way, the Commission can ensure the development of price floors for VDT service rates that cover all relevant costs.

Contrary to NYNEX's arguments, VDT competition realistically cannot be expected on a full and fair playing level unless video dialtone is subjected to a considerable amount of regulatory scrutiny. Such regulatory scrutiny is appropriate in instances, such as here, where the "market failure"[5/] characteristics of the telecommunications industry enable LECs such as NYNEX to leverage their absolute control of "bottleneck" network resources to limit

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[4/] The Commission explicitly noted that telephone companies "could engage in cross-subsidization and predatory pricing by setting rates for their video dialtone services below their incremental costs and recover such costs from telephone ratepayers." VDT Price Cap Notice at ¶1, n.2; see also In the Matter of Price Cap Performance Review for LECs, First Report and Order, CC Docket No. 94-1 at ¶414 ("First Report and Order").

[5/] Market failure can occur for a number of reasons. In the case of LECs, market failure results from: extreme economies of scale and scope in the production of local telecommunications service; nearly a century of LEC infrastructure development that is legally and economically protected from anything greater than token competition; the establishment of an extensive and near-ubiquitous network; and the existence of direct customer relationships with virtually every business and residence in the LEC's service territory.

competitive entry into adjacent market segments, such as VDT. Consequently, effective regulation of "a fledgling start-up service"[6] such as VDT is necessary because the risks that NYNEX and other LECs may engage in predatory pricing to chill competition in the VDT marketplace greatly outweigh NYNEX's unsupported concern that it is "hobbled" by excessive regulation.[7]

Finally, the risk of anticompetitive cross-subsidization is even more considerable in the case of VDT because many LECs, including NYNEX, intend to provide VDT services over the same network used to provide consumers with telephony services, thus giving LECs the additional opportunity unfairly to burden telephony ratepayers with video dialtone costs. Accordingly, NYNEX's argument that it be allowed to set video dialtone rates flexibly should be rejected.

II. THE COMMISSION SHOULD USE A SEPARATE VIDEO DIALTONE PRICE CAP BASKET TO HELP DETER ANTICOMPETITIVE CROSS-SUBSIDIZATION

A price cap mechanism will do little to deter anticompetitive cross-subsidization, however, unless the Commission properly establishes an underlying price cap mechanism for video dialtone that: (1) segregates video dialtone costs from other regulated service costs;[8]

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[6] See NYNEX Comments at 3.

[7] Id. NYNEX's attempt to blame the delays in the availability of commercial VDT service on the Commission is meritless. Id. at 3-4. As demonstrated by Bell Atlantic's recent decision to reconsider its video dialtone applications -- which was expected to provide service to millions of potential customers -- as well as the much publicized delays in the implementation of digital technology, the Commission may not be held accountable for delays in the LEC provision of video dialtone service.

[8] Indeed the Commission has recognized that "it will remain important to avoid grouping services with different levels of competition in the same basket . . . to limit LEC ability to engage in anticompetitive cross-subsidization." First Report and Order at ¶414.

(2) eliminates the low-end adjustment and earnings sharing mechanism; and (3) accurately sets initial rates for video dialtone service according to sound principles of cost causation.[9] Although NYNEX maintains that video dialtone services should not be subject to the price cap mechanism, to the extent that the Commission approves such a mechanism, NYNEX agrees with NECTA that the Commission must place video dialtone services in a separate price cap basket,[10] employ a productivity factor of zero[11] and recommends that VDT direct costs and revenues not be included in the calculation of a LEC's interstate rate of return for purposes of the sharing and low-end adjustment mechanisms.[12]

NYNEX's position regarding the setting of initial rates, however, is untenable. As a starting point, the FCC must properly review LEC video dialtone cost studies -- and solicit comments from all interested parties -- before setting initial rates. The process of determination and approval of appropriate initial rates for video dialtone services is essential. Such rates must appropriately reflect the costs experienced by NYNEX and other LECs before a price cap mechanism is implemented. In the absence of a meaningful examination of the current relationship between rates and costs of VDT service, a separate VDT price cap mechanism could have the undesirable effect of providing the LECs with the ability to cross-

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[9] A key protection for monopoly telephone ratepayers, and for competitors in the video market, is the requirement that the LECs' set their initial rates for video dialtone service at a level that recovers all relevant costs. In the Matter of Telephone Company - Cable Television Cross-Ownership Rules, Sections 63.54 - 63.58, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, CC Docket No. 87-266, 10 FCC Rcd 244 at ¶¶217-220 (Nov. 7, 1994).

[10] NYNEX Comments at 4-5.

[11] Id. at 6-8.

[12] Id. at 10.

subsidize rates because they will have been set without full knowledge of whether the "costs are truly the consequences of a carrier's decision to provide video dialtone service."[13] Proper costing requires that all the incremental costs of VDT must be assigned to that service. Given the LECs' propensity for allocating the large majority of video dialtone costs to telephony, a careful review of the LECs' cost studies is likely to demonstrate that the LECs have understated the incremental costs properly attributable to VDT service by an overwhelmingly wide margin.

Accordingly, the Commission should establish an investigation into the true video dialtone costs of NYNEX and other LECs so that the Commission may determine that monopoly telephone revenues are not being used improperly to subsidize LEC entry into the video dialtone marketplace.

III. PRICE CAPS ALONE WILL NOT PREVENT ANTICOMPETITIVE CROSS-SUBSIDIZATION OF VIDEO DIALTONE SERVICES, PARTICULARLY WHERE LECS SUCH AS NYNEX ELECT THE LOW-END PRODUCTIVITY OFFSET OF 4.0 PERCENT

The Commission must recognize, however, that even the proper implementation of an appropriate VDT price cap mechanism will not alone prevent anticompetitive pricing of video dialtone services. The FCC's modified price cap framework does not preclude NYNEX from shifting costs from more competitive services -- such as video dialtone services -- to monopoly telephone services. As an example, the FCC's retention of a low-end adjustment and earnings sharing mechanism gives the LECs the opportunity to engage in cross-subsidization of competitive services through excessive rates for monopoly telephone

[13] Video Dialtone Reconsideration Order at ¶217.

services. Although numerous LECs have chosen the high-end, no sharing productivity offset of 5.3%, NYNEX has chosen the low-end productivity offset of 4.0%.[14/] Accordingly, NYNEX has the opportunity to "spend" otherwise sharable earnings from telephone services to subsidize VDT rates.[15/] Moreover, given that the FCC plans to reevaluate the productivity offset further before adopting a "permanent" methodology,[16/] NYNEX and the other LECs (including those that have opted for the high-end, no-sharing productivity offset of 5.3%) have ample incentive to manufacture lower earnings and higher costs so as to persuade regulators to adopt a lower productivity hurdle to apply to future rates.

[14/] See "LEC Price Cap Filings Reflect Competitive Changes," Communications Daily at 5 (May 11, 1995).

[15/] Because NYNEX has chosen the low-range productivity offset, it has the obligation to share earnings over a set benchmark with telephone ratepayers by reducing its rates for telephone services in the following year. See First Report and Order at ¶20.

[16/] See, e.g., Id. at ¶¶150-164.

CONCLUSION

For the reasons set forth above, NECTA asks the FCC to place video dialtone services in a separate price cap basket, exempt the VDT basket from sharing and the application of a productivity factor, and thoroughly examine all costs caused by LEC deployment of video dialtone before setting initial rates.

Respectfully submitted,

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May 17, 1995

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CERTIFICATE OF SERVICE

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